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SUBJECT: CRISIS AT SIEMENS - JUST HOW BAD IS IT?

REF: Berlin 46

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SUMMARY  
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¶1. Manufacturing giant Siemens, a household name in Germany and in much of the world, has become embroiled in a recent string of scandals ranging from "outsourced" job losses to accusations of bribery of customers and unions that have tarnished the firm's reputation. Even before the March 27 arrest of a senior executive, some began to speculate that at least some of the multiple investigations of the firm might ultimately lead to the office of CEO Klaus Kleinfeld, who has blamed the corruption charges on rogue employees. Regardless of Kleinfeld's direct involvement or knowledge of any wrong-doing, he has his work cut out for him as he presides over a once-proud symbol of German technological might now badly in need of an ethical makeover.

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SIEMENS: THE "GE" OF GERMANY  
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¶2. Munich-based Siemens, one of the world's largest electrical engineering and electronics companies, is effectively the "General Electric" of Germany, both in terms of its corporate profile, but also in terms of its iconic name, which appears on everything from light bulbs and dishwashers to laptop computers and train locomotives. Founded 160 years ago, the company has approximately 475,000 employees in over 190 countries, including over 66,000 in the U.S. In fiscal 2006, Siemens had sales of Euro 87.33 billion (USD 116.6 billion) and net income of Euro 3.03 billion (USD 4.1 billion). Its U.S. sales amounted to roughly Euro 17.38 billion (USD 23.2 billion).

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BEN-Q - OUTSOURCING JOB LOSSES  
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¶3. Siemens current round of troubles began in September 2006, when Munich-based BenQ Mobile announced it would file for bankruptcy, with the potential loss of 3,000 jobs in Germany. The German cell-phone handset unit of Taiwan-based BenQ had just a year earlier been "sold" by Siemens to BenQ for one Euro -- although Siemens sweetened the deal by paying BenQ Euro 413 million (\$552 million) to take the money-losing division off its hands. The widespread perception of the BenQ affair was that Siemens, under the direction of new cost-cutting CEO Klaus Kleinfeld, had effectively "outsourced" the shuttering of the handset division and firing of its workers to BenQ, in order to avoid the complications and negative publicity that would come to Siemens had it directly closed the division. The criticism came nonetheless, but now with the

added accusation that Siemens had paid the Taiwanese to do its dirty work.

¶4. Even Chancellor Merkel got into the act; during her address commemorating the 2006 Day of German Unity, she reminded Siemens of its special responsibility for the 3,000 BenQ staff who were about to lose their jobs. She said: "In this respect, a traditional [German] company must show responsibility for its former staff. This responsibility must be observed now. By doing this, Siemens could strengthen confidence in the social market economy." As a result of the heavy criticism leveled at the company, Siemens announced that it would set up a special fund with 35 million Euros (\$47 million) to assist workers impacted by the BenQ bankruptcy.

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WE HAVE SLUSH FUNDS FOR TELECOM...  
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¶5. Just as it appeared Siemens had mitigated the damage from BenQ, on November 15 some 200 police, attorneys, and tax authority investigators raided about 30 offices and homes of current and former Siemens employees, including the offices of management board members and CEO Kleinfeld, seizing 36,000 documents. Police arrested half a dozen people -- including a former Siemens management-board member and a former chief financial officer of the telecom unit. The investigation was initiated when banks in Austria, Switzerland and Italy detected a slush fund of Euro 20 to 30 million (\$27-40 million), which the banks suspected were used for money laundering. Authorities suspect the money was used for paying bribes, via sham consulting contracts, to secure contracts related to the Olympic Games in Athens 2004 as well as for telecommunication projects in Saudi-Arabia, Kuwait, Egypt, Indonesia, Russia and Vietnam. By December, Siemens disclosed to authorities that it had uncovered Euro 420 million (\$545 million) in suspicious transactions stretching back more than seven years.

MUNICH 00000196 002 OF 003

¶6. Not only did Siemens allegedly pay bribes, but it also apparently paid out additional money in some instances to cover up the bribes. A former Siemens telecommunications equipment executive allegedly helped broker a \$50 million settlement in 2004 with a Saudi consulting firm that had threatened to forward documents to U.S. authorities detailing bribes paid on Siemens' behalf, according to press accounts of former telecom unit finance chief Michael Kutschenreuter's statements to prosecutors. Following his arrest in November, Kutschenreuter reportedly told prosecutors that top management -- including CEO Kleinfeld and predecessor Heinrich von Pierer -- were informed of the payment, which he described as "hush money."

¶7. Kutschenreuter also reportedly told prosecutors about an encryption code he alleged was widely used at Siemens to itemize bribe payments. He said it was derived from the phrase "Make Profit," with the phrase's 10 letters corresponding to the numbers 1-2-3-4-5-6-7-8-9-0. Allegedly the code was used to convey the amount of a bribe to be paid - for example, with A standing for 2 and I for 9 and P for 5, a reference to "file this in the AIP file" meant a bribe was authorized at 2.95 percent of a contract's value. A spokesman for Siemens said it had no knowledge of a "Make Profit" encryption system. German Authorities continue to investigate the bribery scandal at the telecom division. Additionally, the U.S. Department of Justice is investigating "possible criminal violations of U.S. law by Siemens" in the matter, while the enforcement division of the Securities and Exchange Commission is conducting an "informal inquiry" into the allegations of wrongdoing.

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...AND SLUSH FUNDS FOR POWER GENERATION TOO  
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¶8. In a separate case involving bribery by Siemens power-generation unit, a former Siemens AG executive told a German court on March 13 that he had authorized millions of dollars in bribes to win supply contracts with Italian utility Enel SpA, but claimed he didn't break any laws. Andreas Kley, the former finance chief of Siemens's power generation equipment unit, and another former employee face charges they paid roughly Euro 6 million (\$7.9 million) in bribes between 1999 and 2002 to help a consortium led by Siemens win gas turbine supply contracts with Enel valued at Euro 450 million (\$601 million). Siemens could be hit with a new round of fines if the

court rules that illegal payments were made on its behalf.

¶9. Kley, who left Siemens in 2004, said Enel officials approached Siemens for bribes and that he agreed to make the payments from a special fund he controlled for "discretionary payments." In the Enel case, the money allegedly was transferred through companies in Liechtenstein, Dubai and Abu Dhabi before being channeled into bank accounts in Switzerland and Liechtenstein. Kley said the payments weren't illegal, because the bribed Enel officials didn't fall within the legal definition of civil servants. Instead, he said, he regarded them as representatives of a private-sector company. While Germany broadened its anticorruption laws in 2002, allowing prosecutors to charge people who bribe private-sector officials abroad, the law can't be applied to the Enel case, because it took place before the law was enacted.

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SLUSH FUNDS FOR BUYING UNIONS  
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¶10. At the same time Siemens was allegedly paying bribes to influence customers abroad, it is also alleged to have been secretly funding a Siemens-friendly union at home. On March 27, following raids on several Siemens offices, German prosecutors arrested Johannes Feldmayer, a member of the Siemens management board and the company's second-highest-paid official after Kleinfeld. Feldmayer is accused of transferring about Euro 34 million (\$45.4 million), to Wilhelm Schelsky, recently jailed for tax-evasion.

¶11. Allegedly, Feldmayer approved the payments to a consulting firm run by Schelsky, which were then funneled to the Siemens-friendly union also headed by Schelsky, the Association of Independent Employees (AUB), as a counterweight to the powerful IG Metall union, which claimed that AUB sometimes blocked its positions in labor talks. The IG Metall labor union announced April 2 that it would press charges against Siemens for breaking German law by trying to influence labor through bribes. This action would be especially threatening for Siemens's management because IG Metall officials and its members hold nearly half the seats on the company's supervisory board (board of directors), which has the power to decide the fate of individual executives.

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CEO KLIENFELD: SIEMENS TO BE MODEL OF TRANSPARENCY  
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¶12. In other separate, on-going investigations, U.S., French and German authorities are looking into whether Siemens officials bribed Saddam Hussein's regime to secure contracts under the UN's Oil-for-Food program. Additionally, on January 24, the European

MUNICH 00000196 003 OF 003

Commission imposed a Euro 423 million (\$565 million) penalty on Siemens for price fixing among providers of gas-insulated electric-power switchgear. However, until the arrest of Feldmayer, the top officials of Siemens had remained relatively free of blame for the string of scandals at the company. CEO Klaus Kleinfeld, who prosecutors have so far said is only a witness and not a suspect, has blamed the various corruption charges on "rogue" employees.

¶13. Ironically, the day before Feldmayer's arrest, Kleinfeld appeared at the "13th International Conference on Competition" in Munich, where he gave a speech to government regulators, including U.S. Federal Trade Commission Chairman Deborah Majoras. In his remarks, Kleinfeld said that coming to the conference felt like "climbing into the lion's den" given the firm's recent negative publicity. He reiterated to the audience that Siemens had a zero tolerance for illegal behavior and pointed to the company's efforts to deal with the scandals, including its cooperation with authorities, as well as its hiring its own auditors and investigators. Furthermore, he predicted that Siemens would ultimately be admired for its efforts and would be seen as a benchmark for transparency.

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COMMENT  
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¶14. While Siemens reputation in Germany has not sunk to the level of an Enron or Tyco yet, the damage cannot be understated, as the

symbol of "Germany Inc." has now become fair game for editorial cartoonists and television comedians. Siemens remains profitable and its stock price stable -- what's more difficult to gauge is the currency of the firm's "good name." Even without further high-profile arrests, potential customers and shareholders have to view a potential relationship with Siemens somewhat more cautiously than before. As for Kleinfeld himself -- he continues to maintain that he is both innocent and unaware of wrongdoing. However, given the breadth of alleged corruption at Siemens, the CEO's claim of ignorance of a pervasive culture of corruption is almost as unsettling as the thought of his direct involvement in it.

¶15. This report has been coordinated with Embassy Berlin.

¶16. Previous reporting from Munich is available on our SIPRNET website at [www.state.sgov.gov/p/eur/munich/](http://www.state.sgov.gov/p/eur/munich/) .

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